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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

MAY 29 1998

In the Matter of	)	
	)	
Proposals to Revise the Methodology for Determining Universal Service Support	)	CC Docket Nos. 96-45; 97-160
	)	
	)	

To: Common Carrier Bureau

REPLY COMMENTS OF CELPAGE, INC.

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SUMMARY

Of the more than three dozen comments filed in this proceeding, only two or three sets of comments directly or indirectly addressed PRTC's proposal and the "unique" concerns of insular areas. In general, there was no consensus that there is something unique about Puerto Rico that warrants a wholesale exemption from any of the proposed cost study models or cost-based justifications for federal universal service subsidies.

The FCC can delay the day of reckoning by postponing until January 2001 the use of a proxy model for determining USF support in Puerto Rico; but, it will not be able to resolve this issue until it deals squarely with the real costs of providing service in Puerto Rico. The mere fact that Puerto Rico is an island does not account for poor quality telephone service, low penetration rates, and the highest number of employees per telephone line in the United States. PRTC has many obvious, inherent problems that the FCC should not ignore.

The right thing to do is for the Commission to continue to fund 100% of the USF support in Puerto Rico at the 1998 level until such time as a comprehensive public scrutiny of PRTC's costs and practices in Puerto Rico is completed, with ample local industry input. Because local regulatory authorities lack the necessary power to thwart anti-competitive ILEC practices, the FCC should also ensure that any proxy model ultimately adopted in Puerto Rico does not provide PRTC with unfair advantages over local competitors.

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REPLY COMMENTS OF CELPAGE, INC.

Celpage, Inc. ("Celpage"), by its attorneys and pursuant to Section 1.415 of the Commission's Rules, 47 C.F.R. § 1.415, hereby submits these Reply Comments in response to the FCC's April 15, 1998 Public Notice ("Notice") in the above-referenced proceeding. In particular, Celpage responds to the "Proposal of Puerto Rico Telephone Company" ("PRTC"), which would maintain Universal Service support in "insular areas" at their current levels, should any proposed proxy model reduce support payments below their current levels. Celpage previously filed "Comments" in this proceeding.

I. Summary of Pertinent Comments.

Of the more than three dozen comments filed in this proceeding, only two or three sets of comments directly or indirectly addressed PRTC's proposal and the "unique" concerns of insular areas. In general, there was no consensus that there is something unique about Puerto Rico that warrants a wholesale exemption from any of the proposed cost study models or cost-based justifications for federal universal service subsidies.

The Association of Competitive Telecommunication Providers ("APCT") responded to the "Proposal of Puerto Rico Telephone Company," which would maintain universal service support in insular areas at their current levels until at least January 1, 2001, should any proposed proxy model reduce support payments below their current levels. APCT concurs with PRTC, stating that without this waiver there would be drastic disruptions of telecommunication services, and Puerto Rican telecommunications companies would be placed in financial turmoil, jeopardizing service to consumers.

Though APCT supports PRTC's proposal, APCT requests that because of PRTC's anti–competitive and monopolistic behavior, and the overly broad language used in PRTC's proposal, PRTC and its proposal should be subject to additional conditions and modifications. Conditions that APCT wishes to impose on PRTC are: the elimination of unlawful cross–subsidies; cost–based rates and charges; the "transition period" ending at a definite date; and that PRTC should be required to submit quarterly reports to the FCC and local regulatory authorities. APCT adds that although PRTC may be using universal service funds inefficiently, cutting these funds would increase access and interconnection charges in Puerto Rico, and would adversely affect competition in Puerto Rico.

Virgin Islands Telephone Corporation ("Vitelco") commented that the existing cost–based benchmarks will not work for insular areas because these methodologies do not adequately take into account the unique circumstances of companies servicing insular areas, and the proposals do not provide complete federal funding for companies servicing insular areas. Vitelco urges the Commission to (1) recognize the special status of insular carriers; and (2) adopt a methodology that would permit the federal government to continue to fully fund universal service in insular areas.

Vitelco argues that it especially needs full federal funding for universal service because no intrastate toll service exists in the Virgin Islands to generate funding to subsidize high–cost local service. According to Vitelco, customer rates would rise significantly if federal funding is set at a level below 100%, in contravention of the intent of Congress. Vitelco also says it is hit with a "triple whammy" because it is rural, high cost, and an insular carrier all at the same time, which renders it incapable of contributing to the universal service programs.

Vitelco urges the Commission to closely examine the proposal of Senator Conrad Burns, which provides that the federal universal service fund tap revenues for both interstate and intrastate services, which should cover 100% of the required high–cost fund. Vitelco also partially supports the proposal of the "Ad Hoc Working Group" ("AHWG"), and its implementation of "hold harmless" provisions to ensure that support levels are maintained at sufficient levels. Vitelco does not agree; however, with the basic assumption on which the AHWG plan is founded; specifically, the assumption that the 25% approach would be used for insular carriers, which Vitelco argues would not provide sufficient funding to the Virgin Islands. Vitelco rejects the US West proposal and the TIAP proposal for the same reason.

Although not directly responding to PRTC's proposal, many commenters support the general concept that all universal service subsidies should be cost-based. This notion is supported by representatives from virtually every corner of the telecommunications industry, including local exchange carriers, inter-exchange carriers, and public utility commissions.

For instance, AT&T finds that none of the alternative proposals for determination of high cost support should be utilized. AT&T believes that the major non–rural LECs do not require any universal support under the present conditions, because their local service revenues alone cover all of their universal service costs. Thus, AT&T wants the FCC to cancel all federal payments to the major LECs until they can show that the contribution from these sources has fallen below the forward–looking economic cost of universal service. Therefore, AT&T finds it inconceivable that the FCC would consider implementing a new universal service system in which funding would actually increase. Additionally, AT&T would like the FCC to calculate universal service support on a study area basis instead of a wire center basis. Finally, AT&T believes that the FCC should defer implementation of a new system until there is evidence of local competition.

Ameritech finds that universal service support has historically been directed to companies that, more often than not, have rates below the local rates of non–recipients, and is sometimes directed to companies whose need may be questionable in light of the advanced state of their network. Ameritech urges the FCC to consider that until states seriously evaluate their intrastate aspects of universal service, demands to expand federal high cost funding beyond current levels are premature.

Ameritech finds that the Telecommunications Act of 1996 clearly envisions a shared federal and state responsibility to move from implicit to explicit support mechanisms with states being obligated to support competitive entry and to eliminate subsidies which negatively impact competition. Creating a larger federal fund could have the effect of encouraging states not to address this matter. Ameritech contends that the current 25% proposal, modified to permit rural telephone companies to continue to receive benefits at current levels, maintains the current support flow mechanism without creating a windfall. In addition, Ameritech believes the assessment and recovery of funds should be competitively neutral and should include economically rational rate structures. Finally, Ameritech supports the system of permitting rural carriers to continue to obtain federal universal service funds in the same manner they have been in order to promote service to historically under served areas.

The Competitive Telecommunications Association ("Comptel") supports the goals of universal service to make subsidies explicit, competitively neutral, and available to any recipient willing to meet the established criteria. Comptel would like a joint federal–state effort to devise a single fund, which it believes would be more efficient than a federal fund supplemented by 50 intrastate funds. Alternatively, Comptel suggests that the FCC work with the states to develop a consistent cost model and revenue benchmark in order to ensure that double recovery is avoided and the funds are no larger than necessary. Comptel also believes that any system put into place should be based on geographic de–averaging and cost methodology should be identical for both unbundled network element pricing and determination of universal service support costs. As far as the timing for implementation, Comptel supports AT&T's proposal to postpone implementation of the high cost support mechanism for the major ILECs until those companies have opened their markets to widespread local competition.

Even state regulators agree that these subsidies should be cost-based. The California Public Utilities Commission ("CPUC") supports a federal universal service mechanism for funding high cost areas, that is cost–based. The principles that CPUC would like implemented in a high cost funding system are: (1) using forward–looking costs to determine high cost support; (2) targeting federal support to exceptionally high cost areas, that is, areas that exceed a multiple of the nationwide average cost; (3) not exceeding the overall level of funding contemplated by the FCC's proposal; (4) tempering the high cost mechanism in order to minimize the burden on those that contribute to it and reducing distortions in the marketplace caused by such mechanism; (5) continuing to base contributions to the federal high cost support mechanism on interstate revenue; (6) continuing recovery of federal contributions through charges associated with interstate services; and (7) administrating simple methodology for determining high cost support.

Additionally, CPUC urges the FCC to use a cost–based benchmark based on a multiple of the nationwide average cost; not to attempt to address issues concerning access rate structures that are unrelated to high cost through the high cost program; and to fund the program by surcharge or interstate end user bills which reflect the FCC's end user interstate revenue assessment base.

II. Response to PRTC Comments/Proposal.

PRTC filed comments in support of its own proposal. PRTC seems to believe that it has an unqualified right to continue receiving the same level of revenue and federal subsidies as it had prior to the introduction of local competition. Its proposal seems to suggest that the Universal Service Fund is essential to make PRTC whole after its income is reduced due to newfound competition under the Telecommunications Act. On the other hand, PRTC's comments and its proposal are remarkably silent with respect to how and when it will improve operations, reduce waste and excessive overhead, and improve services to all its customers, including non-subsidized business and residential customers.

PRTC's opposition to some of the proposals that would increase the federal subsidy can only be logically linked to its hope that the local universal service fund will become a formidable barrier to local competition. Hence, if PRTC's Proposal is approved, PRTC would achieve the objectives of: (1) maintaining the USF support at the current levels which cannot be supported by any forward looking cost methodology; (2) ignoring any need to improve the operational efficiencies of PRTC; and, (3) raising a huge barrier to effective local competition by means of a large local tax on gross telecommunications revenues.

PRTC's proposal silently assumes that its costs are efficient; therefore, its current costs must be the accurate costs of providing service throughout Puerto Rico. PRTC assumes that these must be the cost levels to be used as a base in any universal program support mechanism. Therefore, it concludes that it is not fair to reduce the support levels PRTC currently receives for the High Cost and LTS support programs. According to PRTC, any reduction in those support levels will inevitably result in an increase in access charges or increased residential rates.

This self-serving analysis has one basic flaw: PRTC's costs are highly inefficient due to two decades of operating without independent regulatory oversight, responding to the latest political directives regardless of the costs or merits, political patronage hiring and appointments, and the utter lack of any profit motive or efficiency objectives due to government ownership. PRTC's inefficiencies have been laid bare under either of the proposed cost models. It is also apparent that the FCC faces a very unique problem in PRTC's case: neither Congress when drafting the Telecom Act, nor the FCC when drafting the Universal Service Orders, could have known the consequences of applying an impartial, cost-based support model to PRTC's uniquely inefficient operations.

PRTC's response to the results of these cost-based formulas was to be expected. It now needs to "manipulate" these formulas to arrive at its desired result: maintenance of the *status quo ante*. PRTC wants to keep receiving $15 in universal service support for every dollar it contributes to the fund. PRTC doesn't even attempt to argue that the proposed formulas are mistaken; it merely argues that *any* cost-based formula will provide little relief to PRTC's uniquely inefficient operations. Even GTE's proposed model is rejected by PRTC because it provides an inadequate $100 million in support; that is, PRTC rejects a tenfold return for every dollar it will pay into to the universal service fund. By stark comparison, competitive carriers such as Celpage will be paying, under *any* proposed federal high cost support formula, roughly 3% of their gross revenues into a fund from which they will receive *no* returns.

III. Comparison of Puerto Rico's Subsidies and Demographics.

PRTC has previously asked the FCC to treat it like a "rural" carrier for purposes of Universal Service support; the FCC has rejected that request. PRTC's recent Proposal is essentially the same request; but, this time PRTC seems to suggest that being an insular area telephone company is akin to being a rural telephone company. Also, PRTC points to its abysmally low 76% penetration rate in Puerto Rico as justification for the rest of the nation to continue to subsidize PRTC's operations at an obviously disproportionate level. PRTC Proposal at 7.

Celpage and most businesses in Puerto Rico have previously explained to the FCC why PRTC has failed to deliver basic telephone service to 94% (the national average) of the people of Puerto Rico, and, why PRTC has come to depend on enormous subsidies for basic services. None of those reasons has anything to do with the fact that Puerto Rico is, obviously, an island. Indeed, if the FCC were to compare Puerto Rico's demographics and geography to any state in the Union, it would have to question where all this money is going that PRTC receives each year.

For instance, Puerto Rico is only about 105 miles long by 35 miles wide, a total of 3,492 square miles, which is approximately the size of Connecticut. Although it is a mountainous island, it is not nearly as mountainous as Montana and Wyoming, states which are substantially larger than Puerto Rico, yet rank far lower in terms of monthly USF support payments per local loop: Montana is \$7.54; Wyoming is \$6.49, and Puerto Rico is \$10.21. In fact, the only state with a higher monthly support per local loop is Alaska, at \$13.89 per loop. So, topography and geography certainly do not account for the inordinately high monthly supports paid to PRTC.

The Telecom Act, Congress and the FCC all reasonably assumed that the costs of providing service to rural areas are higher than those costs in urban areas. But, the majority of Puerto Rico's population lives in urban areas. According to the latest Census Bureau figures, Puerto Rico's total population as of July 1, 1997 was 3,827,038; but more than half that population lives in the 15 largest municipalities in Puerto Rico, which each have a population of more than 50,000, including San Juan -- 433,705; Bayamon -- 231,845; Ponce -- 189,988; Carolina -- 188,427; and Caguas -- 140,114. The total population for the top 15 cities in Puerto Rico is 1,951,263.

In short, unlike LECs in such states as Alaska, Montana, and Wyoming, PRTC has failed to efficiently use its existing, generous support subsidies to deliver basic telephone services to 25% of its population, even though no one in Puerto Rico lives more than 10 miles away from the nearest city. These shortcomings cannot be solely attributed to Puerto Rico's "insular" nature. Hawaii is an insular area, and very mountainous, yet, its monthly support payments per local loop are only $0.14, compared to PRTC's whopping $10.21 per loop. The differences between Hawaii and Puerto Rico are these: Hawaii receives service mostly from an independent, efficiently-run, publicly owned telephone company, GTE; Puerto Rico, on the other hand, is served by the PRTC, which is none of those things.

PRTC wants the FCC to meekly accept that its $146 million annual subsidies are justified, when there is absolutely no evidence that PRTC's practices have *ever* been cost-justified. Although PRTC claims that the two proposed cost studies suggest some inequitable consequences for PRTC; the contrary conclusion seems more likely: even the more generous of the two cost studies proves that PRTC's costs are way out of line from what they should be. Since the local regulatory authority has only limited authority to examine and regulate PRTC's practices, and in light of PRTC's government ownership, it is crucial for the FCC to conduct this analysis, rather than continuing to issue an annual blank check to PRTC. Before the FCC blithely approves the continuation of this enormous subsidy to PRTC, it needs to spend some time investigating precisely how PRTC spends these subsidies. In addition to a thorough review of PRTC's operational and pricing practices, the FCC needs to impose certain express conditions on PRTC's continued receipt of its existing annual support payments to avoid any recurrence of a pattern of problematic practices in Puerto Rico.

IV. Conditions Should be Imposed on PRTC.

The FCC should impose the following express conditions on PRTC before approving PRTC's Proposal for continued USF support without any cost justifications.

1. Eliminate Unlawful Cross-Subsidies.

PRTC itself has openly admitted in the past years that it has cross-subsidized its competitive services, such as paging and cellular, with monopoly-based revenues, employees, facilities, and practices. For instance, until recently, PRTC had been unlawfully subsidizing its payphone services; that practice did not stop until PRTC was sued by a local private payphone competitor. For years, PRTC has provided preferential interconnection services and rates to its wholly-owned CMRS affiliates. For years, PRTC has been pricing its competitive CMRS services at or below costs.

Since the FCC has allowed PRTC a waiver of the separate subsidiary requirements for competitive services, PRTC has until now managed to shield these unlawful cross-subsidies from most public scrutiny. The FCC should put an immediate end to these unlawful practices, by requiring PRTC to establish a separate subsidiary for its competitive services. In addition, the FCC should order PRTC to make all its books and accounts available for public scrutiny should there be any further instances of apparent unlawful cross-subsidies.

2. **PRTC's Rates and Practices Must Become Cost-Based.**

PRTC evidently wants the FCC to essentially "reverse engineer" the USF formula, to produce the result it wants, which is to keep receiving for the foreseeable future its annual $146 million subsidies. PRTC's Proposal has not even attempted to explain why it needs such a large subsidy, or how it has spent this money each year for the past decades. Now that Celpage, and every telecommunications carrier in the U.S., has to contribute to pay for PRTC's enormous subsidy, all of these carriers, and certainly all Members of Congress, are entitled to some serious explanations from PRTC.

The FCC should by no means accept the fact that Puerto Rico is "insular" and relatively poor, as justification for this continued subsidy. PRTC should be required to face no more or less regulatory scrutiny than applies to LECs in all 50 states of the Union. If PRTC cannot cost-justify its practices, then the FCC will need to recalculate PRTC's subsidies. Presumably, no Member of Congress would be willing to allow 25% of the nation's high cost support funds to flow to a phone company that won't even consider telling anyone how it has spent this money.

In exchange for granting PRTC this generous exemption from the cost-based models, the FCC should order PRTC to produce cost-based explanations for all its rates and services, including interconnection and access charges. Moreover, PRTC needs to make this analysis in comparison to the costs of comparable carriers throughout the U.S.; otherwise, PRTC will simply be justifying its subsidies based on its current bloated payroll and inherent inefficiencies (for instance, PRTC's employees per lines in service ratio is dramatically higher than any other carrier's in the U.S.). If PRTC will not voluntarily agree to make its rates cost-based (plus a reasonable rate of return), then the FCC may need to reconsider whether PRTC is entitled to a waiver of the cost-study obligation to continue to receive its high subsidies.

3. This "Transition Period" Should End at a Definite Deadline.

The FCC should clearly state that PRTC will have until a date certain to justify this "waiver" of the proxy model; beyond which time it will qualify for USF supports on the same criteria as all other urban carriers. Moreover, it PRTC is sold to another telecom carrier, this exemption should immediately terminate. Absent these definite deadlines, PRTC will continue to do what it has historically done with the FCC: continue to plead that it is a "special case" that requires continual waivers of the FCC's rules, without proving the merits of that preferential request. Now that PRTC is playing with the rest of the nation's money, Congress and the FCC need to put an end to this history of regulatory forbearance toward this unregulated monopoly.

CONCLUSION

The FCC can delay the day of reckoning by postponing until January 2001 the use of a proxy model for determining USF support in Puerto Rico; but, it will not be able to resolve this issue until it deals squarely with the real costs of providing service in Puerto Rico. The mere fact that Puerto Rico is an island does not account for poor quality telephone service, low penetration rates, and the highest number of employees per telephone line in the United States. PRTC has many obvious, inherent problems that the FCC should not ignore.

The right thing to do is for the Commission to continue to fund 100% of the USF support in Puerto Rico at the 1998 level until such time as a comprehensive public scrutiny of PRTC's costs and practices in Puerto Rico is completed, with ample local industry input. Because local regulatory authorities lack the necessary power to thwart anti-competitive ILEC practices, the FCC should also ensure that any proxy model ultimately adopted in Puerto Rico does not provide PRTC with unfair advantages over local competitors.

WHEREFORE, for all these reasons, Celpage respectfully requests that the Commission adopt PRTC's Proposal on an interim basis, but only with the forgoing conditions.

Respectfully submitted,

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Date: May 28, 1998

CERTIFICATE OF SERVICE

I, Rhonda M. Johnson, a secretary in the law offices of Joyce & Jacobs, do hereby certify that the foregoing Reply Comments of Celpage, Inc., was served, on this 29th day of May, 1998, by first class U.S. mail, postage prepaid upon the following:

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